

General Information Letter: A subchapter S corporation and its qualified subchapter S subsidiary are treated as a single subchapter S corporation.

March 18, 1999

Dear:

This is in response to your letter dated February 4, 1999. Given the nature of your inquiry and the information you provide, I am responding with a General Information Letter. This is not to be taken as a statement of Department policy or as a binding ruling by the Department. As general information gathered in response to your particular questions, however, I hope that it is helpful to you. See 2 Ill. Admin. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

We are writing on behalf of our corporate clients who have elected for federal income tax purposes to be taxed as an "S" corporation. In connection with such an election in several instances a separate QSSS election has been made to treat a subsidiary as liquidated into the parent and therefore treated as a division if you will, for federal income tax purposes.

Finally, some of the S-Corporations are 100% owned by an employee stock ownership plan (ESOP).

Based upon the facts as set forth above, we are requesting your opinion as to how your state would apply income, sales/use, or UBIT taxes in the following scenarios:

Situation I

S-Corporation is owned 100% by an ESOP. Under present federal law, all of the income or loss of the S-Corporation will flow through to the ESOP. Again, under present law such income will not be subject to the unrelated business income tax or UBIT.

Please advise as to whether your state will impose any income to UBIT tax in this situation.

Situation II

Same facts as in I above, but in addition the S-Corporation has made a QSSS election for its 100% owned subsidiary. Does this change your answer?

Nexus Issues Resulting from the QSSS Election

Sales/USE Tax

What is the impact of the QSSS election for sales/use tax nexus? For example, if the parent above does not have nexus, does the QSSS election for the subsidiary (assuming it has nexus) result in nexus for both or does the fact that they are still separate legal entities control?

Similarly, if the parent has nexus will you require the subsidiaries sales to be subject to the appropriate sales/use taxes.

Income Tax

For an S-Corporation subject to income/franchise taxes, would your state impute the nexus of one to the other such that the total income would be subject to apportionment?

Response

This letter is in response to the income tax issues. Another section of this office will respond to any Sales/Use Tax questions.

With regard to the ESOP ownership of an S-Corporation, Section 201 of the Illinois Income Tax Act (IITA) imposes an entity-level tax of 1.5% of allocable net income, called the Personal Property Tax Replacement Income Tax, on all S-Corporations doing business in this State. Even if the stock is held in an Employee Stock Ownership Plan (ESOP), an S-Corporation having income from doing business in Illinois will have a Replacement Tax liability at the corporate level.

Assuming it has nexus in this state, the ESOP trust would be taxed in Illinois in accordance with IITA Section 203(c), which begins its computation with the taxable income "properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code," (IITA, Section 203(e)). The additions and subtractions to federal taxable income in 203(c) do not include a component for Unrelated Business Taxable Income (UBTI), so the federal treatment of UBTI for the ESOP will not be altered for the Illinois tax.

You ask whether a Qualified Subchapter S Subsidiary (QSSS) election will change anything about this treatment of the S-Corporation. Previous ruling letters from this Department have explained how the QSSS election is treated under the IITA. (Two examples would be Letter No. IT 98-0057-GIL, 1998 Westlaw 858210; and Letter No. IT 98-0022-GIL, 1998 Westlaw 466830.)

Briefly, Section 102 of the IITA declares that any term used therein has the same meaning as it has when used in a comparable context in the Internal Revenue Code (IRC). Any entity treated as a corporation in the IRC is treated as such by the IITA. Since a QSSS is treated as a part of its S-Corporation parent in the IRC, it is treated as such for all income tax purposes in Illinois. A subchapter S corporation and any QSSS it owns must therefore file an Illinois income tax return as a single corporation and include all items of income, deduction and credit of the parent and the QSSS in the return. No separate election is required for Illinois purposes.

With regard to nexus, the QSSS election can have an effect. If the parent and the subsidiary were not a unitary business prior to the QSSS election and the subsidiary had nexus, but the parent did not, then the election will confer nexus on the parent where it had none before. Two separate non-unitary corporations become a single corporation with Illinois nexus after the election.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit

all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

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